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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**Date Issued:** September 21, 2009

**IBA Report Number:** 09-74

**Land Use and Housing Committee Date:** September 23, 2009

**Item Number:** 8

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# San Diego Housing Commission Finance Plan for Acquisition of New Affordable Housing Units

## OVERVIEW

On September 11, 2009, the Board of Commissioners of the San Diego Housing Commission (SDHC) approved the SDHC “Finance Plan for Acquisition of New Affordable Housing Units.” At the September 23, 2009 meeting of the Land Use and Housing Committee (LU&H), the SDHC will present this plan to the members of the LU&H Committee, prior to its planned presentation to the Housing Authority on October 6, 2009.

The SDHC requests the approval of “*a financing plan for the production of a minimum of 350 units of affordable housing and authorize the procurement of financing for the acquisition, rehabilitation and/or new construction of the affordable housing by the SDHC and authorizing all necessary and appropriate actions to implement such procurement of financing.*”

The phased finance plan, as presented in Attachment 5 of report # LUH09-005 (Report) and reviewed below, covers a period from FY 2009 through FY 2014. The LU&H Committee is being asked to review eight proposed actions of the Housing Authority, as recommended by SDHC staff. Additionally, the Report provides attachments detailing underwriting guidelines to the proposed financings, a timeline outlining the associated financings and acquisitions, and a balanced portfolio analysis conducted by Keyser Marston Associates.

Under the proposed finance plan, the SDHC estimates that approximately 1,035 additional units of affordable housing will be acquired by leveraging 1,254 of its 1,371 total units of former-public housing portfolio. The Housing Commission staff is requesting a financing plan that would utilize up to \$200 million of loan proceeds generated by placing debt on the real estate portfolio and new acquisitions; however the Report estimates total borrowing of approximately \$102.6 million.

SDHC staff has briefed the IBA on the proposed finance plan. This report provides an overview of the actions requested of the Committee, reviews the financing plan and notes questions identified by the IBA that the LU&H Committee may wish to have addressed by the Housing Commission staff and finance team prior to the plan's consideration by the Housing Authority.

## FISCAL/POLICY DISCUSSION

### Previous Housing Authority Action

On July 21, 2009, the Housing Authority approved a bond inducement resolution (a declaration of official intent) for up to \$200 million in taxable and/or tax-exempt rental housing revenue bonds secured by some or all of the Housing Commission's existing rental units. This action represented an initial step toward the possible issuance of Housing Authority mortgage revenue bonds that could benefit from the interest reimbursement provisions of the Build America Bonds (BABs) authorized by the American Recovery and Reinvestment Act of 2009. Although this initial action was requested for the issuance of housing revenue bonds, it was also necessary to secure the BABs interest reimbursement provision for other possible forms of financing. The finance plan currently before the LU&H Committee contemplates borrowing from Fannie Mae and FHA instead of issuing housing revenue bonds.

### Housing Authority Actions Requested

The Report provides eight staff recommendations/actions for the Committee to review before the plan is forwarded to the Housing Authority. As several of these actions generated questions or comments for the IBA, we have presented these comments/questions following each of the requested actions below. The IBA recommends that SDHC Commission staff address these comments/questions for clarification in their presentation to the LU&H Committee.

1. **Approve a financing plan that would utilize up to \$200 million of loan proceeds generated by placing debt on the San Diego Housing Commission's real estate portfolio (formerly public housing) and new acquisitions, utilizing the following financing mechanisms:**
  - a. **Fannie Mae conventional mortgage;**
  - b. **FHA 221(d)(4) program (new construction and substantial rehabilitation) or FHA 223(f) program (minor rehabilitation), allowing the financing to qualify for an American Recovery and Reinvestment Act of 2009 stimulus program "Build America Bonds ('BABs')," which financing is only available to governmental entities for a limited period of time and provides a direct federal subsidy equal to 35% of the interest cost of such financing thereby reducing the cost of debt, as further detailed in this report.**

The finance plan anticipates borrowing against 1,254 of the 1,371 rental housing units owned by SDHC. As noted in the Report, the larger properties would be separated into two groups, one to secure Fannie Mae financing and the other to secure FHA financing that qualifies for the BABs interest rebate program. Although approval is sought for a financing plan of up to \$200 million of loan proceeds, the SDHC

financing team currently estimates a total borrowing of approximately \$102.6 million from Fannie Mae and FHA. *Although the IBA has been informed that additional financing authorization has been requested to allow for additional borrowing capacity, the LU&H Committee may wish to ask the SDHC financing team to clarify their future borrowing expectations.* If SDHC staff believes the \$200 million authorization is too high, direction should be provided to reduce the authorization amount.

2. **Authorize the San Diego Housing Commission to refinance the affordable housing that is acquired, rehabilitated or constructed and that have been acquired as 100% cash acquisitions, thereby allowing the San Diego Housing Commission to place mortgages on these new affordable units to further leverage the cash purchases and utilize the BABs program on these further refinancings secured by such new units (an eligible use of the program) before the sunset of the program on December 31, 2010.**

In total, SDHC estimates that approximately 1,035 additional affordable rental housing units will be acquired under the proposed finance plan. Although specific detail associated with future acquisitions has yet to be determined, SDHC staff has identified a "pipeline" of potential acquisition properties in anticipation of receiving proceeds from the requested financing. In presenting the finance plan to the SDHC Board of Commissioners on September 11, 2009, SDHC staff described a property acquisition plan that involved two phases.

It is estimated that the first phase of acquisitions will result in 915 additional rental units; 550 rental units will be acquired with FHA/Build America Bond financing and an additional 365 units will be acquired with Fannie Mae financing. Using equity from properties acquired in the first phase, SDHC staff anticipates that another 120 rental units can be acquired before December 31, 2010 (in order to qualify for the BABs interest rebate which expires at that time), for a total of 1,035 additional affordable rental housing units.

3. **Approve the parameters for financing as referenced within the financing plan as coordinated by NorthMarq Realty Services, Inc. (SDHC's financial advisor) and analyzed by Keyser Marston Associates ("KMA") as referenced within this report.**

It appears that the referenced financing parameters are presented in the table on page 6 of the Report; however, supporting "conservative assumptions" are also described on page 7 of the Report. *The IBA recommends that the SDHC financing team explain the relevance of these parameters and assumptions to the LU&H Committee as they relate to viability of the finance plan. It is not clear which financing parameters must be adhered to and which can be modified, if any.*

4. **Authorize the San Diego Housing Commission to form wholly owned Limited Liability Companies (LLCs) and/or 501 (c)(3) nonprofit corporations or similar “special purpose entities” as and when required by Fannie Mae and/or FHA as a condition of financing and as required for financing.**

The rationale for forming LLCs, 501(c)(3)'s, or "special purpose entities" is not clear. While it appears that these legal entities may be required to isolate income on particular properties (rather than have income pooled from several properties to secure several loans) in order to secure a single loan, *the IBA recommends that the SDHC financing team explain the need for this request.*

5. **Authorize a three-year capital expenditure budget of up to \$200 million to include the financing proceeds for the purposes outlined in this report, with the resulting debt service and operating costs associated with the capital expenditure activity to be reflected in the San Diego Housing Commission’s annual budget which is presented to the Housing Authority for approval.**

SDHC staff has indicated that a final decision regarding how and when to incorporate the budget of the finance plan into the Housing Commission’s annual budget has yet to be determined. Possible approaches for including the proposed finance plan in the Housing Commission’s budget are further reviewed in the report section below entitled "Capital Expenditure Budget".

6. **Authorize the San Diego Housing Commission to reimburse all third parties either directly or through the selected underwriters associated with the financing of the acquisitions, including compensation for the finance team as referenced within this report.**

SDHC is responsible for third party costs described on pages 7 and 8 of the Report to include: third party consultant reports (\$800,000); HUD application fees for the FHA financing (\$170,000); reimbursing lenders for legal, title and miscellaneous closing costs; and required HUD fees (unspecified). *The IBA recommends that SDHC staff more fully explain these fees and identify other third party costs, if any.*

7. **As detailed in this report:**
  - a. **Confirm the retention of NorthMarq Realty Services, Inc. (“NorthMarq”) as a financial advisor and authorize payment of fees to NorthMarq upon the closing of financings as referenced within the report;**
  - b. **Authorize the retention of PNC and Greystone as underwriters and/or lenders and authorize payment of compensation to such entities upon the closing of the financings;**
  - c. **Authorize retention of Orrick Herrington & Sutcliffe as attorneys to be involved in the issuance of bonds and/or financing on behalf of the Housing Commission; and,**
  - d. **Authorize retention of Wade Norris of Eichner & Norris as a financing attorney to be involved in the FHA and BABs financings.**

NorthMarq has been retained as SDHC's financial advisor and has developed the finance plan that is before the LU&H Committee. It is not clear what the financial advisory fee is for their work to develop the finance plan. NorthMarq will additionally receive a loan origination fee (equal to .0075% of the total borrowing, or \$770,000 if \$102.6 million is borrowed). ***The IBA recommends that SDHC staff describe the total compensation for NorthMarq and the services received for the origination fee.***

The IBA has been informed that PNC (FHA loans) and Greystone (Fannie Mae loans) have been retained as specialty loan processors. Estimated compensation for these services has not been provided within the report. ***SDHC staff should briefly describe the nature of these services and estimate the total expense associated with the contemplated loans.***

SDHC staff is requesting the retention of Orrick Herrington & Sutcliffe (\$250,000) as attorneys to be involved in the financing. They are further requesting that Wade Norris of Eichner & Norris (\$150,000) be retained as a financing attorney to be involved in the FHA and BABs financings. ***As housing revenue bonds are not being contemplated, the IBA recommends the nature and difference of these legal services be explained.***

- 8. Authorize the President and CEO, or designee, of the San Diego Housing Commission and the Executive Director of the Housing Authority of the City of San Diego to execute any and all documents and to perform any and all acts reasonably necessary to implement the financing plan, provided, however, that each acquisition project shall be approved by the Board of Commissioners of the San Diego Housing Commission under the terms of the Acquisition Policy previously approved by the Housing Authority and the City Council of the City of San Diego.**

This action represents a significant delegation of authority to execute a multi-year finance plan involving over \$100 million of borrowing and the acquisition of numerous properties. ***Given the significance of the finance plan, the IBA recommends SDHC staff apprise the Housing Authority semi-annually in writing and/or annually at a public meeting on the status of the plan.***

### Capital Expenditure Budget

Housing Commission staff has indicated that although they have yet to incorporate the finance plan into the agency's annual budget, the following two approaches are under consideration:

- 1) The finance plan could be incorporated into the Housing Commission's annual budget, as a fund within the Rental Housing Development activity of the budget, or

- 2) SDHC may establish a separate capital expenditures budget allocating operating costs and income for this activity. This approach would be similar to the City's Capital Improvements Program budget.

A couple of factors should be considered in evaluating these approaches. First, if the finance plan is to be incorporated into the annual budget, SDHC staff should set a date for docketing this budget amendment at the Housing Authority. One opportunity for incorporating the finance plan into the budget could be at the time of the Housing Commission's annual fall budget revision, tentatively scheduled to come to Housing Authority in November 2009.

### San Diego Housing Commission Real Estate Acquisition Policy

On March 24, 2009, the Housing Authority amended the SDHC Real Estate Acquisition Policy to authorize the Housing Commission to acquire and finance properties. As stated in the Policy and noted in the report, the Housing Commission "is authorized to review, approve, and execute any and all documents necessary and/or appropriate to effectuate the acquisition(s)" to "alleviate the foreclosure crisis and/or to meet the goal of acquiring a minimum of 350 units as mandated by HUD in its approval of San Diego Housing Commission's application for the disposition of public housing." In the case of acquisitions under the finance plan, all acquisitions must be brought to the SDHC Board for approval.

It is important to note that all actions to acquire properties taken by the Board of Commissioners may be reviewed by the Housing Authority within seven days of the date of Housing Commission approval. If, however, no requests are received from the Housing Authority within seven days, any action concerning any acquisition shall become final. This means that any property acquisitions and/or increases in financing (up to \$200 million) would not require Housing Authority review or approval.

Additionally, the above policy stipulates that the Housing Commission must abide by the state relocation law in the case that acquired properties are occupied. SDHC staff has confirmed that a relocation plan and relocation budget will come forward with each property acquisition.

### Acquisition of Affordable Housing under Finance Plan

As part of the 2007 public housing disposition agreement between the SDHC and HUD, the SDHC must acquire a minimum of 350 affordable housing units at or below 80% AMI (in San Diego 80% Annual Median Income, as determined by HUD, constitutes an annual income of \$66,100 for a family of four). The report states and staff has confirmed that all units will be acquired at or below 80% AMI for family acquisitions and rehabilitation and new construction and at or below 50% AMI for senior acquisitions and new construction or new construction.

Furthermore, SDHC staff has indicated that Housing Commission's consultant Keyser Marston has incorporated conservative balanced portfolio assumptions into the cash flow analysis. For example, in its analysis of family property acquisition and rehabilitation, HUD requirements allow for the acquisition of properties at a maximum of 80% AMI, calculated to be \$1,488/month in rent for a two-bedroom unit in San Diego. Staff has informed the IBA that

Keyser Marston assumed the income on these properties at \$950/month, or 51% AMI. According to Housing Commission staff, the overall affordability levels for current anticipated acquisitions assumed in the cash flow range from 36% to 54% AMI.

### Property Acquisition Approach

According to the finance plan, all properties acquired will include community participation and outreach efforts. The IBA has been informed that SDHC staff will meet with respective community planning groups to solicit a recommendation that will be communicated in the acquisition report to the Housing Commission.

### Reserves

To this date, approximately \$10.7 million of net property income has been generated from the portfolio of properties SDHC received from HUD. According to the finance plan, and as illustrated in Table 3 of Keyser Marston's balanced portfolio analysis, \$5 million of the \$10.7 million will be deposited into a contingency reserve account to support the finance plan if needed. The remaining balance of \$5.7 million will be added to the anticipated loan proceeds and used for acquisitions.

## CONCLUSION

The IBA commends the SDHC financing team for developing a plan of finance plan that promises to significantly add affordable rental units (estimated to be 1,035) to their real estate portfolio over the next few years. If successfully implemented, this finance plan would more than satisfy SDHC's agreement with HUD to leverage the equity in the former public housing units to create a minimum of 350 additional affordable housing units. The IBA has been informed that the 1,366 housing units that were the subject of the above referenced agreement continue to be rented to low income households at rent levels affordable to either 50% AMI, 80% AMI, or at market rate rents, whichever is less. We further understand that this is the first time HUD has transferred properties to a public agency in this manner.

As noted earlier in this report, approving the eight actions associated with this finance plan represents a significant delegation of authority to SDHC management. They will be charged with autonomously executing a multi-year finance plan that is estimated to involve over \$100 million of borrowing and the acquisition of numerous properties. Given the significance of the finance plan, the IBA recommends SDHC staff apprise the Housing Authority semi-annually in writing and/or annually at a public meeting on the status of the plan.

If periodic briefings on the finance plan are not required, there will not be a planned opportunity for the Housing Authority to receive a written or public briefing on a finance plan of this magnitude. In accordance with the current SDHC Real Estate Acquisition Policy and the requested actions outlined in the Report, once the finance plan is approved no additional approvals will be required of the Housing Authority. Future property acquisitions will not require Housing Authority approval unless a member of the Housing Authority specifically requests that it be docketed within seven days of approval by the SDHC Board.

In presenting the requested finance plan to the LU&H Committee and subsequently to the Housing Authority, the IBA recommends that SDHC staff address the comments and questions we have raised for each of the eight requested actions. The required parameters, assumptions and cash flow analysis presented in the Report should be explained to best understand the finance plan. As SDHC hired Keyser Marston to independently review the finance plan, the IBA recommends that members of the LU&H Committee and the Housing Authority ask Keyser Marston to directly comment on the viability of the plan, its underlying parameters, any associated cash flow or market risks, and/or any other questions they may have.

**[SIGNED]**

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